DEC 1 1 1995

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Price Cap Performance Review for	)	CC Docket No. 94-1
Local Exchange Carriers;	)	
Treatment of Video Dialtone	)	
Services Under Price Cap Regulation	)	DOCKET FILE COPY ORIGINAL

OPPOSITION OF
SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company (SWBT) hereby submits its Opposition to the Petitions for Reconsideration (PFRs) of the Second Report and Order.[1] filed by MCI Telecommunications Corporation (MCI) and Cox Enterprises, Inc. (Cox), in which MCI and Cox object, *inter alia*, to the Commission's adoption therein of a *de minimis* threshold beyond which a LEC is required to segregate video dialtone (VDT) costs and revenues from those for telephony for purposes of the price cap sharing and low-end adjustment backstop mechanisms.

Most of the arguments against the *de minimis* threshold in the Petitioners' PFRs are the same arguments they made in comments they filed in response to the companion Third Further Notice of Proposed Rulemaking (Third FNPRM).[2] SWBT explained the flaws in

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[1] In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Second Report and Order and Third Further Notice of Proposed Rulemaking, FCC 95-394, ¶¶ 1-38 (released Sept. 21, 1995) (Second R&O). The last section of this order (¶¶ 39-42) is referred to as the Third FNPRM.

[2] Third FNPRM, Id. ¶¶ 39-42. Comments of MCI Telecommunications Corp. (Oct. 27, 1995) (MCI Comments) filed in Third FNPRM; Comments of Comcast Cable Communications, Inc. and Cox Enterprises, Inc. (Oct. 27, 1995) (Cox Comments) filed in Third FNPRM.

Petitioners' objections to the *de minimis* threshold in SWBT's Reply[3] filed in response to the comments, including those of the Petitioners, on the Third FNPRM. SWBT opposes Petitioners' PFRs on the same grounds explained in SWBT's Reply, which is incorporated herein by reference.[4] By reference to SWBT's Reply to the same arguments previously made by Petitioners, SWBT outlines some of its responsive points.

MCI objected to the *de minimis* threshold for three reasons, in that MCI erroneously believed it would "(1) contradict existing Commission cost allocation systems, (2) require costly and cumbersome auditing procedures to enforce, and (3) will likely to permit [sic] video dialtone carriers to cross-subsidize their video dialtone offerings with revenue from other common carrier services."[5]

A fundamental flaw in the Petitioners' position is illustrated by MCI's assumption that the *de minimis* threshold "would exempt LECs from cost allocation requirements"[6] and Cox's assumption that the Second R&O "leaves the allocation of costs between video and telephone services entirely to the discretion of the carrier."[7] On the contrary, the creation of the *de minimis* threshold does not pertain to any of the Commission's "existing . . . cost

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[3] Reply of Southwestern Bell Telephone Company (filed Nov. 20, 1995) (SWBT Reply) filed in Third FNPRM, attached as Exhibit "A" to this Opposition.

[4] For the Commission's convenience, a file-stamped copy of SWBT's Reply is attached as Exhibit "A" to this Opposition.

[5] MCI PFR at 1; cf. MCI Comments at 1.

[6] MCI PFR at 1; MCI Comments at 1.

[7] Cox PFR at 3; cf. Cox Comments at 6.

allocation systems,"[8] and hence, it cannot contradict them, as MCI alleges. The *de minimis* threshold serves the limited role of determining when to segregate VDT costs and revenues for purposes of the price cap sharing and low-end adjustment mechanism (LFAM) calculations. This is actually a departure from the existing LEC price cap plan because costs of individual price cap services or baskets previously were not identified and excluded from the sharing and LFAM calculations.[9]

Contrary to Petitioners' vague allegations, all of the Commission's existing cost allocation and accounting procedures remain intact and are not affected by the *de minimis* threshold. Petitioners are seriously mistaken in believing that other cost allocation issues, such as Part 32/Part 36 allocation of common costs between VDT and telephony, are pertinent to the decision to create a *de minimis* threshold.[10] Such issues were not decided in the Second R&O and are not the proper subject of any reconsideration of the Second R&O.

MCI also contends that a *de minimis* threshold is inconsistent with Commission cost allocation policy because, as MCI claims to believe, there is no precedent for a *de minimis* exception in any existing cost allocation procedure.[11] While MCI's PFR quoted from and relied upon the Commission's rulings in Docket No. 86-111,[12] MCI conveniently failed to

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[8] See SWBT Reply at 9-11.

[9] Likewise, price cap excluded services, although excluded from the sharing and LFAM calculations, also do not require identification of service-specific costs for this purpose.

[10] SWBT Reply at 9-11.

[11] MCI PFR at 2-3; MCI Comments at 3-4. Cox commits the same error in assuming that a *de minimis* exception is without precedent. Cox PFR at 6.

[12] MCI PFR at 3-4 (citing Joint Cost Order, CC Docket No. 86-111, 2 FCC Rcd 1298, 1312 (1987)); MCI Comments at 4.

notice that the very same ruling it cited adopted the Part 64 cost allocation exception for incidental activities, which is subject to a ceiling of one percent of a LEC's total revenues.[13] Moreover, other precedents exist in the more relevant context of interstate ratemaking and, in particular, price caps.[14] In any event, the *de minimis* threshold does not relate to any of the existing accounting or cost allocation procedures referenced by MCI and Cox; rather, the Second R&O calls for a new procedure for excluding the revenues and costs of price cap regulated service from the price cap backstop mechanism calculations. Accounting and cost allocation precedents under Parts 32, 36, 64 and 69 are irrelevant in this context.

Petitioners claim that the creation of a *de minimis* threshold and the failure to address unrelated cost allocation and accounting issues will allow LECs to cross-subsidize VDT service and "limit[ ] substantially the value of a separate [VDT] price cap basket."[15] Petitioners claims in this regard ignore the sufficiency of the price cap safeguards to prevent cross-subsidy, as explained in SWBT's Reply.[16] They also fail to recognize that the cost allocation issues they raise are or should be the subject of separate proceedings or involve unrelated subjects, such as Part 64, which have already been resolved. Despite the existence

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[13] Joint Cost Order, CC Docket No. 86-111, 2 FCC Rcd 1298, 1308 ¶ 77 (1987). See also 47 C.F.R. §§ 32.11(a)(2), 32.103, 32.2000(j), 32.4999(n), 32.5999(h), 32.6999(b) (simpler account structure for Class B companies, *i.e.*, those with less than $100 million in annual revenues).

[14] SWBT's Reply at n.25.

[15] Cox PFR at 2; cf. Cox Comments at 2 ("creation of a separate [VDT] price cap basket will be a wasted effort...."). SWBT's Reply already responded fully to Cox's misguided arguments concerning interpretation of Part 36 rules as applied to VDT plant. See SWBT Reply at 11-12. This proceeding is not the proper place to debate the interpretation of Part 36 rules. Id. at 12.

[16] SWBT Reply at 3-6.

of the *de minimis* threshold, the price cap safeguards will supplement or duplicate the effect of competition in the telephony, and especially the video, marketplace. For example, assuming arguendo that competitive forces do not fully perform the task, the price cap "new services" test is designed to assure that initial VDT prices are reasonable, the price cap plan's restriction on the maximum prices of other interstate services is designed to assure LECs cannot raise other prices to cover any VDT costs, and the lower pricing band is designed to assure that subsequent VDT prices are not lowered too far.[17]

Contrary to Petitioners' claims, the *de minimis* threshold need not be designed in a manner that is costly or burdensome to administer or monitor. The simple method suggested by SWBT in its Comments - based on the percentage of households passed - would not impose any administrative burden.[18] Even certain alternative methods could be designed using simple calculations. Assuming costs must be excluded at all -- which is a major departure from the original price cap plan design -- a *de minimis* threshold avoids an unnecessary step in an already complex backstop mechanism process. It is clearly reasonable for an agency to simplify this process when any supposed benefits are remote, especially in view of competition and the other sufficient price cap safeguards inherent in a separate price cap basket for VDT.

The *de minimis* threshold only exists because the Commission decided to create a new price cap procedure for VDT in that the Commission has not previously required the costs and revenues of a price cap regulated service to be identified and segregated from the sharing

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[17] Id.

[18] SWBT Comments at 8-10; SWBT Reply at 7-9.

and LFAM calculations.[19] SWBT does not believe they should be excluded,[20] but if they are excluded pursuant to the special price cap procedure for VDT, they should be excluded when it makes sense to do so, *i.e.*, when the benefits of doing so are material to the sharing and LFAM calculation. SWBT recommended a five percent materiality standard. While the alternatives suggested by SWBT would be preferable, Petitioners have failed to show why the *de minimis* threshold is not an efficient and reasonable method of implementing the process the Commission has chosen for the VDT price cap basket.

MCI contends that the Commission must create a separate VDT Part 69 rate element in this price cap proceeding because (1) otherwise "the LECs will have the flexibility to associate [VDT] costs with other Part 69 telephony rate elements . . ."[21] and (2) MCI apparently believes such a VDT rate element is necessary for purposes of the procedure addressed in the Third FNPRM for the segregation of VDT revenues and costs from the sharing and LFAM price cap calculations.[22] Creation of a Part 69 rate element for VDT is not necessary for purposes of any aspect of price cap regulation of VDT or other services. Part 69 rules do not determine the prices of a price cap LEC's services, nor are they used in any other aspect of price cap regulation.[23] Part 36 rules will determine the interstate VDT costs, which

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[19] SWBT Reply at 6.

[20] In fact, as explained in SWBT's Comments and Reply, SWBT believes that if they are excluded, it would be preferable to use as an interim measure the same method the Commission uses for price cap excluded services, *i.e.*, costs equal revenues. SWBT Comments at 7.

[21] MCI PFR at 7.

[22] See id.; MCI Comments at 2, 6-8.

[23] See Comments of BellSouth Telecommunications, Inc. at 4 (Oct. 27, 1995).

would be the most logical method of identifying the VDT costs to be excluded from the sharing and LFAM calculations.[24] MCI's concerns regarding Part 69 VDT rate elements are beyond the scope of this proceeding and are certainly not necessary for purposes of the Third FNPRM's proposals.

Regarding MCI's claim that LECs would have too much flexibility in the Part 69 allocation of VDT costs in the absence of a VDT rate element, the Commission has addressed this concern, beyond the extent truly necessary in light of price cap regulation, by requiring each LEC offering VDT service to obtain a Part 69 waiver for its particular rate structure and by imposing the "financial segregation requirements" in the VDT Recon Order[25] and in its orders granting Section 214 applications to provide VDT service.[26] Even assuming the necessity of these measures given price cap regulation and competitive pressure, they are more than sufficient, when combined with the tariff review process.[27] Certainly, price cap regulation of VDT and other services does not require modifications of Part 36 or Part 69, which modification should be addressed through separate proceedings. Given the potentially wide variety of Part 69 rate element structures for various VDT architectures, the Commission recognized that it

[24] SWBT Comments at 11; Comments of Bell Atlantic at 2 (Oct 27, 1995).

[25] Telephone Company - Cable Television Cross-Ownership Rules, Sections 63.54- 63.58 and Amendments of Parts 32, 36 61, 64 and 69 of the Commission's Rules to Establish and Implement Regulatory Procedures for Video Dialtone Service, CC Docket No. 87-266, 10 FCC Rcd 244, 326 ¶ 173 (1994) (VDT Recon Order).

[26] New Jersey Bell Telephone Co., 9 FCC Rcd 3677, 3685 ¶ 45 (1994).

[27] See In the Matter of The Bell Atlantic Telephone Companies' Petition for Expedited Waiver of Part 69 of the Commission's Rules to Offer Video Dialtone Service in Dover Township, New Jersey, DA 95-1282, Order, 1995 FCC LEXIS 3808 ¶¶ 60-62 (released June 9, 1995) (Bell Atlantic Dover Part 69 Waiver).

would be premature to establish permanent rate elements and cost allocation procedures before the Commission and the LECs have gained more experience with VDT service.[28] Instead, these issues should be handled via Part 69 waivers for VDT and the VDT tariff review process, as indicated in the VDT Recon Order.[29]

CONCLUSION

For the reasons explained herein and in SWBT's Reply in the Third FNPRM, the Commission should reject the arguments contained in the Petitions for Reconsideration filed by MCI and Cox.

Respectfully submitted,

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[28] VDT Recon Order ¶¶ 196-97; Bell Atlantic Dover Part 69 Waiver, ¶¶ 61-62.

[29] VDT Recon Order, ¶ 197.

EXHIBIT A

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BEFORE THE
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WASHINGTON, D.C. 20554

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Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation	)	CC Docket No. 94-1

REPLY OF SOUTHWESTERN BELL TELEPHONE COMPANY

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November 17, 1995

CC Docket No. 94-1

REPLY OF SOUTHWESTERN BELL TELEPHONE COMPANY

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Summary[*]

Subject to SWBT's previous objections to price cap regulation of a competitive video service, SWBT recommends that, in view of the Commission's tentative conclusion to eliminate the backstop mechanisms, the Commission should await the outcome of the other FNPRMs pending before the Commission in this docket before adopting any *de minimis* threshold as proposed here. SWBT urges the Commission to adopt as an interim approach the existing rules for price cap excluded services (*i.e*, costs equal revenues).

Assuming the Commission proceeds with implementation of the *de minimis* threshold prior to resolution of the other FNPRMs, SWBT finds the comments opposing a reasonable *de minimis* threshold to be misplaced and to reflect a misunderstanding of the price cap safeguards. These safeguards are in place as part of the creation of the VDT price cap basket ordered in the Second R&O, from the inception of a LEC's VDT service, prior to reaching any *de minimis* threshold and prior to implementation of any cost allocation procedures. Any opposition to a reasonable *de minimis* threshold should be handled via petitions for reconsideration of the Second R&O. Certain commenters' claims that there would not be any safeguards against cross-subsidy prior to a LEC reaching the *de minimis* threshold are wrong because they fail to recognize the nature of the price cap safeguards, including, the "new services" pricing test, the price cap on interstate access services, the separate VDT price cap basket, and the lower pricing band on the VDT basket. Similarly mistaken are the contentions that the Commission must adopt accounting procedures for the allocation of costs between VDT

[*] All abbreviations used herein are referenced within the text.

and telephony services in order for the price cap safeguards to function to prevent cross-subsidy. The pricing constraints of the price cap rules are effective safeguards against cross-subsidy, even before any cost allocation accounting procedures are adopted.

To sidestep the controversial and problematic rate-of-return or investment methods of calculating the *de minimis* threshold, the Commission should adopt SWBT's suggested simple method: when the percentage of households passed in the study area reaches five percent (5%).

Certain commenters' arguments concerning interpretation of Part 36 rules as applied to VDT plant are beyond the scope of the Third FNPRM, and in any event, misconstrue Part 36 Rules. As SWBT explains in this Reply, VDT plant is categorized as Wideband, C&WF Category 2 pursuant to Section 36.152(a) of the Commission's Rules.

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REPLY OF
SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company (SWBT) hereby submits its Reply to comments filed in response to the Commission's Third Further Notice of Proposed Rulemaking (Third FNPRM)[1] in the above-referenced proceeding. After the Commission decided, in the Second Report and Order (Second R&O),[2] to establish a *de minimis* threshold beyond which a LEC is required to exclude video dialtone (VDT) costs and revenues from those for telephony for purposes of the price cap backstop mechanisms, the Commission requested comments, in the Third FNPRM, on procedures for implementing that *de minimis* threshold and exclusion.[3] The Third FNPRM sought comment on two aspects of such procedures: (1) the level of the *de minimis* threshold and (2) the method of segregating VDT costs and revenues for purposes of the sharing and low-end adjustment mechanisms. A number of the commenters' suggestions are

[1] In the Matter of Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Second Report and Order and Third Further Notice of Proposed Rulemaking, FCC 95-394 ¶¶ 39-42 (released Sept. 21, 1995) (Third FNPRM). The first two sections of this order (¶¶ 1-38) are referred to as the Second Report and Order (Second R&O).

[2] Second R&O, id.

[3] Third FNPRM, id. ¶¶ 39-42.

misplaced because either they do not pertain to the two subjects of the Third FNPRM or they dispute issues already decided in the Second R&O or prior Commission rulings.[4]

I. COMMENTS OPPOSING THE *DE MINIMIS* THRESHOLD ARE MISPLACED.

Several commenters question the creation of a *de minimis* threshold or claim that it should be extremely small.[5] Such questions are misplaced because in the companion Second R&O the Commission has already decided to establish a *de minimis* threshold. Such questions must be addressed, if at all, by means of petitions for reconsideration of the Second R&O.[6] Claims that the *de minimis* threshold should be set at such a low level that it would be meaningless are similarly misplaced and also should have been filed as petitions for reconsideration. However, to the extent commenters argue for a low, but reasonable, threshold, their comments are within the scope of the Third FNPRM. In SWBT's Comments, SWBT urged the Commission to delay adoption of a *de minimis* threshold because it appears that the

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[4] SWBT addresses some of these misplaced comments later in this Reply. However, SWBT also notes two commenters' clearly misplaced suggestion that Part 64 be amended to include procedures to allocate costs between the regulated video and regulated telephony categories. GSA at 2, 8; Comcast/Cox at 5. In the VDT Recon Order, the Commission already has decided not to amend Part 64. Telephone Company - Cable Television Cross-Ownership Rules, Sections 63.54-63.58 and Amendments of Parts 32, 36, 61, 64 and 69 of the Commission's Rules to Establish and Implement Regulatory Procedures for Video Dialtone Service, CC Docket No. 87-266, 10 FCC Rcd 244 ¶¶ 175, 179-181 (1994) (VDT Recon Order). This suggested overhaul of Part 64 is inconsistent with the function of Part 64 of allocating costs between regulated and nonregulated activities. Part 64 should not be used to allocate costs to specific regulated services or between categories of regulated services.

[5] See, e.g., California Cable Television Association (CCTA) at 6-11; Comcast Cable Communications, Inc. and Cox Enterprises, Inc. (Comcast/Cox) at 2, 7; General Services Administration (GSA) at 3-5; MCI Telecommunications Corp. (MCI) at 3-5; National Cable Television Association, Inc. (NCTA) at 6-7.

[6] In fact, MCI and Cox Enterprises, Inc. filed such Petitions for Reconsideration on November 6, 1995.

other FNPRMs in this docket may render any *de minimis* threshold moot, if the backstop mechanisms are eliminated, as the Commission tentatively concluded they should be.[7]

II. EXISTING PRICE CAP RULES ARE SUFFICIENT SAFEGUARDS AGAINST CROSS-SUBSIDY, REGARDLESS OF THE *DE MINIMIS* THRESHOLD.

The commenters' opposition to a reasonable *de minimis* threshold is based upon claims that reflect a misunderstanding of the roles of the *de minimis* threshold and the price cap safeguards. For example, commenters claim that having a *de minimis* threshold would allow LECs to cross-subsidize VDT service.[8] Similarly, some commenters argue that the effectiveness of the newly-created VDT price cap basket in preventing cross-subsidy is tied directly to procedures for allocating common costs between VDT and telephony services.[9] These parties do not recognize or do not understand the safeguards against cross subsidization that exist in the current price cap regulatory paradigm.[10]

First. The Commission has established a "new service" pricing rule for the LEC VDT service offerings that requires that VDT prices exceed VDT direct costs.[11] This test alone

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[7] SWBT at 2-6.

[8] E.g., Comcast/Cox at 7; MCI at 3-5.

[9] See, e.g., CCTA at 5-7; Comcast/Cox at 6-8; GSA at 2-4; MCI at 3-4; NCTA at 3-4.

[10] As SWBT contended in its original comments in this proceeding, SWBT does not believe that any price cap regulation is necessary for VDT service given the highly competitive video marketplace and LECs' *de minimis* or nonexistent presence in the video market. However, given that the Commission has decided to so regulate VDT service, SWBT explains in this Reply how existing price cap rules are more than sufficient safeguards against cross-subsidy of any new service, including VDT.

[11] For VDT, the Commission defined direct costs to include incremental costs associated with primary plant investment dedicated to VDT, incremental costs associated with shared plant, a reasonable allocation of other costs associated with shared plant, incremental costs for non-primary plant accounts associated with VDT and a reasonable allocation of overheads. Second

assures all interested parties that LEC VDT services are not cross subsidized by any other LEC services. By definition, as long as VDT prices are above incremental costs, no cross subsidy exists.[12]

Second. The basic structure of the LEC price cap plan ensures that LECs do not have the ability to change the prices of any interstate access services as a result of any VDT-related costs they incur. By design, the Commission created a price cap plan where the prices of access services are no longer linked to the specific fully distributed costs previously utilized under rate-of-return regulation.[13] Thus, except for the current effects on the sharing and low-end adjustments applicable only to certain price cap LECs, VDT costs can have absolutely no effect on LEC access prices.[14]

Third. The requirement of a separate basket for VDT ensures that LECs cannot increase the prices of interstate access services to recover revenue reductions associated with reducing VDT prices. Because non-VDT services are in separate price cap baskets, changes in VDT prices do not and cannot affect non-VDT prices. As a result, current access customers will not be affected by VDT price changes.

R&O ¶ 4 & n.8.

[12] See NYNEX at 5. See also 3 ANTITRUST LAWS AND TRADE REGULATION (MB) §§ 21.02[3]-21.03[3] (Sept. 1993); Hovenkamp, ECONOMICS AND FEDERAL ANTITRUST LAW §§ 6.8-6.9 (1985); Areeda & Turner, ANTITRUST LAW ¶¶ 710-722 (1978).

[13] See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6791 ¶ 35 (1990) (LEC Price Cap Order).

[14] SWBT supports the elimination of sharing and low-end adjustments for all price cap LECs. Doing so eliminates the last tenuous link between VDT costs and non-VDT prices. In fact, for those LECs that have elected the no sharing option of the price cap plan, there is no linkage at all between costs and revenues.

Fourth. The VDT basket has a lower pricing band that limits the LECs' ability to reduce VDT prices without providing cost support. While SWBT opposes lower pricing band limits in the LEC price cap plan, this constraint currently provides an additional safeguard ignored by several commenters.

Fifth. As the Commission has noted, the actual occurrence of predatory pricing or voluntary pricing below incremental costs is extremely rare.[15] Most parties readily recognize that it would make absolutely no business sense for a LEC to price its VDT services below its incremental costs. Also, the Commission's complaint process[16] and current antitrust laws remain in place.

Clearly, the creation of Part 36/Part 69 cost allocation rules for VDT costs is not necessary to prevent cross subsidization.[17] Commenters that claim that no protection or safeguards exist until LECs are required to comply with some VDT cost allocation rules are completely wrong.[18] These commenters fail to recognize the price cap safeguards described above. Some of them believe incorrectly that a separate price cap basket would not be created until a LEC reaches the *de minimis* threshold. This belief reflects a misunderstanding of the purpose of the *de minimis* threshold. The separate price cap basket for VDT is created at the inception of a LEC's VDT service. It exists before VDT costs reach the *de minimis* threshold

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[15] See LEC Price Cap Order, 5 FCC Rcd at 6824 ¶ 309; In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket 94-1, First Report and Order, 10 FCC Rcd 8961, 9139-40 ¶ 409 (1995) (First Report and Order); ANTITRUST LAWS AND TRADE REGULATION (MB) § 21.02[1][a]&[b] (Sept. 1993).

[16] LEC Price Cap Order, 5 FCC Rcd at 6836 ¶ 406; First Report and Order, 10 FCC Rcd at 9059 ¶ 224.

[17] See VDT Recon Order, ¶ 166.

[18] CCTA at 3.

and functions as a pricing constraint unrelated to the level of fully distributed actual costs incurred. The only purpose of the *de minimis* threshold is to determine when VDT costs would begin to be segregated from all other regulated costs for purposes of the sharing and low-end adjustment calculations. The *de minimis* threshold plays absolutely no part in the determination of initial VDT prices pursuant to the "new services" test established for VDT.

The Commission must not conclude that LECs should set VDT prices equal to some arbitrarily defined estimate of fully distributed costs of VDT.[19] Contrary to allegations of some commenters,[20] the creation of a separate VDT price cap basket does not require any allocation of costs to the VDT basket. The AT&T price cap plan never required the allocation of costs to baskets. The cable TV price cap plan does not require the allocation of costs to baskets. The LEC price cap plan has no such requirement.[21] The pricing constraints represented by the price cap baskets are determined based solely on: (1) the existing prices of services; (2) their historical base period demand levels; and (3) the price cap indexes (PCIs).[22] Thus, the allocation of VDT costs does not affect prices or demand and has only a miniscule potential effect on PCIs through sharing/low-end adjustments (which should be eliminated consistent with the tentative conclusions in the other pending FNPRMs in this docket).

Deprived of their false assumptions, these commenters' arguments against a reasonable *de minimis* threshold have no foundation and should be rejected summarily.

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[19] CCTA at 4.

[20] GSA at 4; MCI at 1, 6.

[21] The only place where FDC costs are used to set prices is in the determination of the maximum subscriber line charges (SLC).

[22] PCI are affected by the GDP-PI, the productivity factor (X), exogenous costs and, for the Common Line basket, usage growth.

III. THE *DE MINIMIS* THRESHOLD SHOULD BE BASED SIMPLY ON THE PERCENTAGE OF HOUSEHOLDS PASSED INSTEAD OF PROBLEMATIC RATE-OF-RETURN OR INVESTMENT METHODS.

In adopting the *de minimis* threshold, in the Second R&O, the Commission explained its reasoning as follows:

> At this juncture, it appears that many of the LECs intending to provide video dialtone will begin with small systems capable of serving a limited number of households. Thus, in the early years, video dialtone investment for at least certain LECs may well be too small to have a significant effect on the LEC's overall interstate earnings as computed for sharing and the low-end adjustment. We believe that establishment of a *de minimis* threshold can be a much simpler matter than the application of an actual cost allocation methodology for assigning costs to the video dialtone basket for purposes of sharing and the low end adjustment. Thus, until a LEC passes such a threshold, we believe that excluding video dialtone costs and revenues from this calculation is an unnecessary administrative burden.[23]

Several commenters recognize these practical and administrative benefits of a *de minimis* threshold.[24] The Commission has established analogous thresholds in other contexts in the past.[25] While the commenters supporting the *de minimis* threshold agree that it is beneficial, there is no consensus on the method of calculating it. The range of opinions is much wider once one considers the suggestions of those opposed to a *de minimis* threshold.

The comments reflect two primary debates over the *de minimis* threshold method: (1) whether and how it should be based on rate-of-return impact and (2) whether the calculation should include total, as opposed to only dedicated, VDT investment. The parties comment on a number of different pros and cons on these two subjects. While SWBT continues

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[23] Second R&O, ¶ 35(emphasis added).

[24] See, e.g., AT&T at 3; BellSouth at 2-3; GTE at 5.

[25] See NYNEX at 3; First Report and Order, ¶ 251; Joint Cost Order, 2 FCC Rcd 1298, 1308 ¶ 77 (1% of total company revenues for incidental activities).

to believe that the best interim alternative would be to use the existing rules for price cap excluded services (i.e., excluded costs equal revenues), as SWBT explained in its Comments,[26] SWBT agrees with those commenters opposing a rate-of-return method as turning the clock back toward rate-of-return regulation.[27] SWBT also believes that a method based on total VDT investment would be problematic, even more so than one based on dedicated investment alone. Notwithstanding SWBT's position on these two issues, SWBT recommends that -- assuming the Commission rejects the use of existing rules for price cap excluded services suggested by SWBT in its Comments -- the Commission use the simple method based on percentage of households passed by VDT because it avoids the obstacles presented by the rate-of-return and investment methods. In fact, in adopting the *de minimis* threshold in the above-quoted text, the Commission alluded to a limited number of households as a characteristic of small VDT systems that would have an insignificant effect on sharing and low-end adjustment calculations.[28] SWBT's proposed method sidesteps all of the controversy concerning the rate-of-return and investment methods. Besides, it is very simple to administer for both the LECs and the Commission. Aside from other advantages discussed in SWBT's Comments,[29] it will be less susceptible to further recurring debate and will minimize the necessity of Commission oversight and monitoring. The CCTA claims that the Third FNPRM's proposed rate-of-return method "is too susceptible to manipulation and regulatory gaming"[30] and that both dedicated and VDT investment must be

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[26] SWBT at 7.

[27] See, e.g., Pacific Bell at 2; BellSouth at 2-3 & n.4; U S WEST at 2.

[28] Second R&O, ¶ 35.

[29] SWBT at 8-10.

[30] CCTA at 11.

included in order to reduce "LEC incentives to misallocate direct [VDT] costs as shared costs."[31] A method as simple as SWBT's percentage of households passed cannot be criticized as being susceptible to any such manipulation or misallocation by the LECs.

SWBT's proposed method is so simple that all it requires is a comparison of the number of households passed by VDT as shown in the VDT Quarterly Report and the total number of working loops in the study area from line 1270 of the ARMIS Access Report (43-04). To illustrate the ease of determining this threshold, a hypothetical calculation is included as Attachment A to this Reply. Once the ratio reaches the five percent (5%) materiality level, the LEC would exclude VDT costs from the price cap backstop mechanism calculations.

IV. THE METHOD OF ALLOCATING PRIMARY PLANT COSTS BETWEEN VDT AND TELEPHONY IS NOT AN ISSUE PRESENTED BY THE THIRD FNPRM.

Several commenters argue allocation issues which are beyond the scope of the Third NPRM. For example, some commenters mistakenly assume that the Third FNPRM is seeking comment on the method of allocating "common costs" between video and telephony for purposes of determining initial VDT prices.[32] These commenters fail to understand the limited purpose of the cost segregation procedure which is the subject of the Third FNPRM: to determine how VDT costs are removed from the price cap backstop mechanism calculations. The Third NPRM does not seek comment on the method of allocating shared primary plant costs between VDT and telephony for purposes of a "new services" pricing test because the

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[31] CCTA at 12.

[32] See CCTA at 3-4, 14-17; Comcast/Cox at 3-5, 7; GSA at 3; MCI at 7-8; NCTA at 2-6. Cf. US WEST at 3 (VDT "cost allocation issues associated with joint and common investments . . . are not price cap issues. They are Part 32 and Part 36 issues").

Commission already decided to address that cost allocation issue in individual LEC tariff review proceedings,[33] such as the one currently being conducted for Bell Atlantic's Dover Township tariffs.[34] All of the comments concerning cost allocation for VDT "new services" pricing purposes are misplaced and should be made in the context of individual tariff review proceedings.

The Third FNPRM does ask whether the same "new services" approach should be used in determining which VDT costs to remove for sharing and low-end adjustment purposes. However, it is asking whether to borrow the same approach for the sharing and low-end adjustment calculations, not how it should apply the "new services" test to determine initial VDT prices. SWBT and other commenters rejected the Commission's suggestion to use the same "new services" pricing approach in the Part 36/Part 69 context.[35]

Different cost allocation procedures exist for different purposes. The incremental cost approach used as part of the "new services" pricing test relies on projections of future costs. This is not the proper method to use to allocate costs pursuant to Part 36, which uses a fully distributed cost approach based on actual or historical costs. Because fully distributed costing is used in jurisdictional separations as well as the sharing and low-end adjustment calculations, SWBT agrees with those commenters who properly recommend that the existing

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[33] VDT Recon Order, ¶¶ 217-220; In the Matter of the Application of New England Telephone & Telegraph Co., 10 FCC Rcd 5346, 5381 ¶ 68 (1995); In the Matter of the Applications of Pacific Bell, File Nos. W-P-C-6913 et seq., Order and Authorization, 1995 FCC LEXIS 5416 ¶¶ 54, 93, 114 (released Aug. 15, 1995).

[34] In the Matter of Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates Terms and Regulations for Video Dialtone Service in Dover Township, New Jersey, CC Docket No. 95-145, Order Designating Issues for Investigation (released Sept. 8, 1995).

[35] See, e.g., AT&T at 7-9.

fully distributed Part 36 rules should be used.[36]

V. COMMENTERS MISINTERPRET PART 36 SEPARATIONS PROCEDURES APPLICABLE TO VDT PLANT.

While SWBT agrees with the commenters who favor the use of existing Part 36 procedures, SWBT does not agree with the interpretation of Part 36 espoused by some commenters. For example, SWBT does not agree with the Comcast/Cox's contention that existing rules would categorize VDT network costs as Category 1 loop plant and assign it predominantly to intrastate.[37] Under the current Part 36 rules, VDT plant will be categorized as Wideband, C&WF Category 2 and not as Category 1 loop plant.[38] Contrary to Comcast/Cox's claim that the "failure to prescribe procedures for allocating costs between Category 1 and Category 2 has left this decision entirely to the discretion of individual LECs . . .," current Part 36 rules dictate that VDT plant be placed in Category 2. Once VDT plant costs are placed in Category 2, direct assignment between jurisdictions is performed.[39] Part 36 assignment of circuit equipment costs follows the assignment of the C&WF costs.[40] Thus, the level of VDT investment assigned to Part 69 and used in segregating VDT costs for purposes of the sharing and low-end adjustment calculations can be determined through the use of the proper existing Part 36 procedures explained above.

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[36] See, e.g., Bell Atlantic at 1-3; SNET at 4; cf. BellSouth at n. 5.

[37] Comcast/Cox at 4, 6.

[38] Compare 47 C.F.R. § 36.152(a)(1) ("Exchange Line C&WF *Excluding Wideband* -- Category 1") with 47 C.F.R. § 36.152(a)(2) ("*Wideband and* Exchange Trunk C&WF-- Category 2"); 47 C.F.R. Part 36 Appendix (Definition of "Wideband Channel").

[39] 47 C.F.R. § 36.155(a).

[40] 47 C.F.R. § 36.126(c)(1).

Contrary to GSA's and Comcast/Cox's misinterpretation, Part 36 does not specify the use of bandwidth in assigning costs to jurisdictions. Both parties misconstrue the "conductor cross section" method required by Section 36.153(a)(1)(i).[41] For example, this conductor cross section analysis requires the LEC to "determine in terms of equivalent gauge the number of pairs in use or reserved, for each category."[42] "Equivalent gauge" is defined as "a standard cross section of cable conductors for use in equating the metallic content of cable conductors of all gauge to a common base."[43] The use of "equivalencies" in these assignment rules refers to copper weight/cost equivalencies. Fiber facilities do not use an equivalency in developing categorized cost. In any event, bandwidth allocations are not representative of cost causation. The cost of facility link (either copper or fiber) is not proportionate to the number of customers served or the bandwidth delivered. Likewise, the cost of equipment units which divide the total capacity of the facility into channels does not change in direct proportion to the number of channels created or the bandwidth of those channels.

The Commission should reject the misinterpretations of Part 36 reflected in certain comments, such as those of GSA and Comcast/Cox. Besides, the purpose of the Third FNPRM was not to seek comments on the interpretation of existing Part 36 rules. Any clarification or modification of Part 36 rules should be left to a comprehensive review of Part 36, and should not be conducted on a piece-meal, service-specific basis.

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[41] 47 C.F.R. § 36.153(a)(1)(i).

[42] 47 C.F.R. § 36.153(a)(1)(i)(A) (emphasis added).

[43] 47 C.F.R. Part 36 Appendix (emphasis added).

VI. CONCLUSION

SWBT's Reply is subject to (1) SWBT's continuing objections to price cap regulation of a competitive video service and to the exclusion of VDT costs and revenues for purposes of the price cap backstop mechanisms and (2) SWBT's preferred recommendation to await the outcome of the other FNPRMs before adopting any *de minimis* threshold because it will be unnecessary in the absence of any backstop mechanisms. In the interim, the Commission should use the existing rules for price cap excluded services. Subject to SWBT's objections and preferred alternatives more fully described in SWBT's Comments herein, if the Commission proceeds to establish a *de minimis* threshold at this time, it should be based on the percentage of households passed rather than the controversial methods debated in the comments filed in this proceeding. Also, it is not necessary for the Commission to amend or interpret any existing rules in order to segregate costs (once the *de minimis* threshold is exceeded) for purposes of the sharing and low end adjustment calculations because existing Part 36 procedures will suffice. In sum, the Commission should reject the misplaced and unwarranted suggestions of commenters discussed in this Reply, and adopt the recommendations set forth in SWBT's Comments filed in this proceeding.